

opportunities to secure a fair return on prudently incurred investment make any such claim speculative, premature, and exceptionally unlikely.⁶⁷

Finally, there is likewise no merit to the ILECs' oft-repeated argument that changes in ratemaking methodology violate some legally protected "regulatory compact." Nothing in the FCC's current access pricing rules establishes any "vested right" or other ILEC entitlement, and, in any event, as the courts have directly held, an alleged "compact" claim adds nothing to allegations that a regulatory change effects a taking. See Duquesne, 488 U.S. at 303, 313; see also Market Street Railway Co. v. Railroad Comm'n of California, 324 U.S. 548, 555, 567 (1945). The Commission has correctly determined that forward-looking, cost-based pricing maximizes consumer welfare and the Act's public interest policies. Accordingly, departures from that determination in the pricing of access would be unlawful.

3. If Any ILEC Underrecovery Claims Could Be Substantiated They Should Be Dealt With By Waiver Procedures.

Finally, to the extent the Commission remains concerned about the possibility of future ILEC underrecovery claims, the Commission could easily address that concern with a waiver procedure that would permit an ILEC to demonstrate, once the commercial consequences of the new competitive regime become apparent, that it was not in fact permitted the opportunity to recover its prudently incurred investment expenses from all revenue sources. For the reasons set out above, AT&T is confident that no ILEC will ever be able to make that

⁶⁷ In any event, a takings claim would be premature and could only arise after a Commission order applied to particular property was found to depress firm earnings below a level that permitted the LEC to raise capital, and went uncorrected by the Commission. See FPC v. Texaco Inc., 417 U.S. at 391-92; see also Williamson County Regional Planning Comm'n v. Hamilton Bank, 473 U.S. 172, 186 (1985).

showing. Nonetheless, a waiver procedure would have the virtues of the similar procedure adopted in Docket No. 96-98,⁶⁸ and would further ensure that more efficient pricing has maximized consumer welfare without unduly sacrificing any clearly established ILEC shareholder interests.

Such a safeguard would be appropriate under any regulatory regime, including the NPRM's "market-based" proposal. As noted above, any rational approach must seek to advance the Commission's goals of driving prices to competitive levels, and thus will at some point (in court or before the Commission) be met by the same, rote ILEC arguments that property has been "taken," that a "regulatory compact" has been violated, that the ILEC has been deprived of the practical ability to recover "interstate allocated" accounting costs from access revenues.

However, there simply is no legitimate reason why fears of ILEC "underrecovery" claims should prevent the Commission from reinitializing access price caps so as to reduce access charges to long-run incremental costs. Such claims are certainly baseless in the aggregate, and are likely to be baseless if and when asserted by individual ILECs. A simple waiver procedure will provide any ILEC with a colorable claim an opportunity to obtain targeted, limited relief.

⁶⁸ Local Competition Order ¶ 739 ("incumbent LECs may seek relief from the Commission pricing methodology if the LEC provides specific information to show that the pricing methodology, as applied to them, will result in confiscatory rates").

III. THE "MARKET-BASED" APPROACH WOULD NOT PRODUCE COST-BASED RATES AND WOULD UNDERMINE INTEREXCHANGE COMPETITION.

Having identified the problems created by overstated access charges, their enormous social costs, and the solution to the problem -- efficient, i.e., forward-looking cost-based, access rates -- the Commission must now do something to make that solution a reality. Merely turning the matter over to "market forces" is no solution. Although AT&T endorses the principle that market forces, when they exist, are preferable to regulation, such reliance is inappropriate *until* they exist. AT&T's concern here is that the Commission's "market-based" approach erroneously equates a partial implementation of regulatory changes that *may* lead to competition with a complete transition to a competitive local exchange market.

As shown below, the proposed "market-based" approach would perpetuate -- and in many instances, exacerbate -- existing inefficiencies, distortions and anticompetitive forces. Because ILECs currently retain monopoly control over exchange access facilities, there simply are no significant market forces at play today. Thus, the "market-based" alternative could more appropriately be called a "monopoly pricing" approach. And, although the future prospect of unbundled elements at TELRIC-based rates holds promise, neither that prospect nor the even more distant prospect of widespread facilities-based competition currently constrains ILEC access prices. Throughout this period, consumers would continue to bear billions of dollars in excess charges. Given all these circumstances, adoption of the "market-based" (i.e., monopoly pricing) alternative would be arbitrary and unreasonable, and therefore unlawful.

A. The Mere Availability Of Unbundled Network Elements Will Not Produce Efficient Access Prices In The Foreseeable Future.

Although the 1996 Act “fundamentally changes telecommunications regulation” (*Local Competition Order* ¶ 1), and the telecommunications landscape undoubtedly will change significantly as a result, how and when it will change remain largely a mystery. One thing is certain, however: no significant local competition exists today. As the Commission has repeatedly found, ILECs “retain considerable market power”⁶⁹ -- as yet there is not even a definitive basis for rejecting the views of many experts that some exchange access and local exchange markets may be natural monopolies.⁷⁰

Although AT&T shares the Commission’s hopes that local competition will *begin* to emerge soon, under no credible scenario will it emerge, much less mature sufficiently to check ILEC market power, instantaneously or ubiquitously. The § 251 requirements adopted by Congress and being implemented by the Commission and the states constitute “an admirable experiment, but one whose success, unfortunately, is not yet certain.”⁷¹

The prospect of unbundled element competition provides a good illustration of the danger of pretending that the 1996 Act somehow legislated local competition into existence. Indeed, no CLEC today provides significant local exchange service using UNEs, and UNEs are not even offered in all markets. And until further measures to limit ILEC abuses --

⁶⁹ SFNPRM ¶ 5; See also Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd. 8691 ¶ 25 (1995).

⁷⁰ See, e.g., Daniel F. Spulber, Regulation and Markets, (Cambridge: MIT Press, 1989) at pp. 3-4; Baumol, Ordover, Willig Aff. ¶ 27.

⁷¹ Baumol, Ordover & Willig Aff. ¶ 27.

particularly in the areas of non-recurring charges and access to operational support systems -- are in place, UNE-based competition will not be economically or technically feasible in many jurisdictions where elements are nominally available. In short, UNE-based competition will not even be *tested* as a means of constraining ILEC prices for some time.

Further, both law and economics dictate that, even when UNE-based competition develops, its existence will still provide only indirect and imperfect pressure on access rates. The Commission has determined that “a requesting carrier that purchases an unbundled local switching element for an end user may not use that switching element to provide interexchange service to end users for whom that requesting carrier does not also provide local exchange service.” NPRM n.81.⁷² Therefore, direct UNE-based exchange access competition is not even allowed. Rather, competition can occur only indirectly for the bundled package of local exchange and exchange access services. Given the ILECs’ current market dominance over both local exchange and exchange access markets, that restriction disadvantages competing carriers and limits the usefulness of UNEs at reducing excessive originating access charges.⁷³

Even ignoring this inefficient legal restriction however, the economic characteristics of terminating access render even ubiquitous UNE-based competition almost entirely ineffective at constraining ILEC pricing behavior. Although the recipient of a long distance

⁷² Citing Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Order on Reconsideration, CC Docket No. 96-98, 11 FCC Rcd. 13042 ¶ 13 (1996).

⁷³ See Baumol, Ordoover & Willig Aff. ¶ 36.

telephone call in a market where ubiquitous UNE-based competition existed could choose the terminating access carrier, the consumer placing the call would nonetheless pay the cost of terminating access. Because of this fact, the recipient has only very indirect (and often nonexistent) incentives to select the least cost terminating access provider. Thus, even widespread, UNE-based competition will impose virtually no downward pressure on ILECs' terminating access rates in the foreseeable future.⁷⁴

Nor could the Commission rationally rely on the prospect of facilities-based competition as a serious constraining force on ILEC access rates. The Commission properly recognizes that facilities-based competition must play an important role in driving exchange access prices to efficient levels. But, like UNE-based local competition, facilities-based local competition is in most markets virtually nonexistent today. And it is widely accepted that significant facilities-based entry is more likely to *follow*, than precede, resale and UNE-based entry. That is because facilities-based competition entails significantly more risk than other forms of entry, and that risk can be reduced only by first establishing customer relationships through less capital-intensive entry strategies.⁷⁵

For these reasons, the Commission's observation that "[m]arketplace forces may not require incumbent LECs to assess cost-based prices for access prices as quickly as a prescriptive approach" (NPRM ¶ 142) vastly understates the flaw in the "market-based" approach. In truth, there is *no* credible scenario under which "market forces" will constrain

⁷⁴ *Id.* ¶ 37.

⁷⁵ *Id.* ¶ 32.

ILEC access prices in the foreseeable future. With so much at stake, the Commission must exercise great care in relying on such potentially ephemeral competitive forces.⁷⁶

B. By Perpetuating Inefficiently High Access Rates, The "Market-Based" Approach Would Impose Enormous Social Costs.

The adverse consequences associated with relying on “market forces” to solve the access problem are the same myriad harms associated with excessive access rates described in Section I above. ILECs will continue to earn monopoly rents, entrants will face a potentially disabling competitive disadvantage, inefficient investment decisions will remain the norm, and consumers will pay unnecessarily high rates for long distance and local telephone services. In this regard, it bears emphasizing that network element competition in one geographic area has little or no impact on access prices in another geographic area. Widespread competition, then, entails UNE competition in every geographic area. And the distortionary effects and high prices associated with excessive access rates are thus likely to be felt most acutely and longer in the rural and other areas where widespread UNE-based competition is likely to take root last.

In sum, the “market-based” approach cannot be reconciled with the principles and results the Commission has already determined to be in the public interest. It plainly will not produce exchange access competition or drive inflated access rates toward efficient cost-based rates anytime in the near future. It will upset long distance competition and, as “traditional industry distinctions” are “blur[red]” and new bundled “packages of services” become

⁷⁶ *Id.* ¶ 38.

available (*Local Competition Order* ¶ 4), it will entrench, rather than weaken, ILEC local monopolies.⁷⁷

C. The "Market-Based" Alternative Would Raise Significant Legal Issues.

Reliance on untested competitive forces to constrain exchange access rates, particularly in the presence of strong indications that market forces will not produce the intended results, would be arbitrary and capricious and contravene the Commission's statutory duty to ensure just, reasonable, and nondiscriminatory rates. Indeed, the D.C. Circuit rejected a similar Federal Energy Regulatory Commission "market-based" initiative on precisely these grounds, finding the agency's "largely undocumented reliance on market forces as the principal means of rate regulation to be . . . misplaced."⁷⁸

The same would be true here. Like the original Communications Act, the 1996 Act mandates just and reasonable rates. And the Commission has not collected any data that would support a conclusion that competition will impose price discipline on monopoly ILECs.⁷⁹ For reasons explained above, no such conclusion could reasonably be reached here.

⁷⁷ Because no exchange access market is currently subject to price constraining competition, there can be no "hybrid" approach that reinitializes price caps in some markets and relies on market forces in others.

⁷⁸ Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1508 (D.C. Cir. 1984), cert. denied, Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc., 469 U.S. 1034 (1984) (footnote omitted).

⁷⁹ 734 F.2d at 1509. The Court stated that, "[i]n setting extraordinarily high price ceilings as a substitute for cost regulation, FERC assumed that . . . existing competition would ensure that the actual price is just and reasonable. Without empirical proof that it would, this regulatory scheme, however, runs counter to the basic assumption of statutory regulation, that "Congress rejected the identity between the 'true' and the 'actual market (continued...)"

IV. THE PART 69 RATE STRUCTURES FOR SWITCHED ACCESS SHOULD BE MODIFIED TO MAKE THEM MORE COST-CAUSATIVE.

Whether the Commission adopts a "market-based" approach or the reinitialization approach described in Section II, the Commission must also make certain changes to the existing Part 69 rate structures for switched access. These changes are necessary to ensure that the resulting access rates comply with the Communications Act.

As the Commission recognizes in the NPRM (§ 6), Part 69's inefficient rate structures have significant anticompetitive effects and are "fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create." More than 90 percent of the ILECs' interstate switched access revenues are collected through the Carrier Common Line Charge ("CCLC"), the Transport Interconnection Charge ("TIC"), and Local Switching ("LS"), despite the fact that much of the \$10.8 billion (NPRM § 29) recovered does not represent an incremental cost of carrier access. Moreover, even the elements that are tied to specific access-related costs do not recover those costs in a cost-causative manner. For these reasons, each of these elements has been widely criticized as failing to recover costs from the cost causer or recovering them in a manner that fails to reflect how the costs are incurred. NPRM §§ 7, 43-44. Because of these distortions, the current switched access rate structure does not

(...continued)

price.” (emphasis added; citations omitted). See also Coal Exporters Association v. United States, 745 F.2d 76, 82 (D.C. Cir. 1984), cert. denied, 471 U.S. 1072 (1985) (ICC erred in making the “general finding” that “in the absence of regulation railroads would be sufficiently constrained by various forms of competition that they would not be expected to abuse any market power they might hold with respect to shippers of export coal.”)

send the appropriate economic signals to customers and carriers, thereby leading to inefficient usage and, in many cases, bypass by high-volume users.

This should come as no surprise to the Commission. Indeed, more than a decade ago, in the original Access Charge Order,⁸⁰ the Commission acknowledged that "[i]n addition to the bypass problem, long run reliance upon usage-based prices for the recovery of fixed-costs will distort economy-wide investment decisions, artificially restrict calling patterns, and may jeopardize the competitive position the U.S. now holds in the world marketplace." Access Charge Order ¶ 112. The Commission further observed that:

"Cost-based rates provide correct signals to the marketplace. Both investors and consumers are certain to respond to such cost-based rates by redirecting their behavior in ways that redound to the benefit of the U.S. economy. In the short run, substantial growth in toll calling could be expected as consumers make better use of the network. In the long run, technologies that make more intensive use of the telecommunications system will create even larger benefits. In an economy increasingly dependent upon information and communications, the dynamic losses caused by investment misdirection can no longer be afforded."

Access Charge Order ¶ 113 (footnotes omitted).

The promise of the 1996 Act cannot be realized unless the Commission acts now to implement fully these findings.⁸¹ In particular, switched access rate structures must be modified to ensure that they assign costs to the cost causer and recover those costs in a manner

⁸⁰ MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 ("Access Charge Order"), recon., 97 FCC 2d 682 (1983), second recon., 97 FCC 2d 834 (1984).

⁸¹ The Commission recognized these same principles in its Section 251 Order in Docket 96-98. Local Competition Order ¶¶ 743-44.

that reflects the way in which they are incurred. This will provide customers and carriers the proper economic incentives to make efficient usage and market entry decisions. Once the rate structures are modified to comply with principles of cost-causation, those structures should remain in place until effective competition in individual markets permits them to be removed.

A. The Carrier Common Line Charge Must Be Eliminated And The Subscriber Line Charge Cap Removed To Allow Full Recovery Of NTS Loop Costs.

A key first step in moving the access charge rate structure toward sound principles of cost-causation is to eliminate the carrier common line charge and the current cap on the Subscriber Line Charge, thereby allowing full recovery of nontraffic-sensitive ("NTS") costs from the subscriber. In the Access Charge Order, the Commission found that recovering NTS costs through flat monthly charges imposed on end users would promote optimal utilization of telecommunications facilities, (Access Charge Order ¶¶ 1, 124; NPRM ¶ 58), and that "it is important to move towards collecting these costs from customers rather than carriers on a flat rather than on a usage sensitive basis." Access Charge Order ¶ 72.

Despite these unassailable and compelling conclusions some 13 years ago, loop costs today are still recovered only in part from flat charges on end users, i.e., subscriber line charges ("SLCs"). Because the Commission has capped SLCs, the remainder of NTS loop costs are recovered from IXC's through the CCLC.

The charge to IXC's for recovery of loop costs violates economic cost-causation principles because the loop cost is not an incremental cost of providing access to carriers. As the Commission has expressly found:

"A subscriber who does not use the subscriber line to place or receive calls imposes the same NTS costs as a subscriber who does use the line. A subscriber who does not make local calls would normally pay a flat fee for the exchange portion of such costs. Imposing a flat charge for the interstate portion of those costs is equally reasonable. Any other procedure violates the general principle that costs should be recovered from the cost-causative ratepayer whenever it is possible to do so."

Access Charge Order ¶ 121. Thus, the fundamental flaw in the CCLC is that it is not assessed directly on the "cost causing" purchaser of the subscriber line. As the Commission recognizes, this arrangement is inherently inefficient because, by failing to assign costs to the cost causer, it sends incorrect signals both to end users and IXC's: "As a result, the common line rate structure forces incumbent LECs to recover costs in an economically inefficient manner, and so may cause inefficient use of the network and uneconomic bypass." NPRM ¶ 58.

Yet, simply changing the usage-sensitive nature of the CCLC to a flat-rate charge, as the Commission proposes, will not eliminate the inefficiencies inherent in this implicit cross-subsidy.⁸² That change would still not force the cost-causer to bear the costs of their usage of the loop facility. Moreover, any continued assessment of the CCLC on IXC's would violate "the mandate in Section 254(e) of the 1996 Act that all support be explicit."⁸³ Indeed, the fact that the CCLC is assessed only on IXC's is flatly inconsistent with Section 254(b)(4), which

⁸² See, e.g., AT&T Comments, filed January 31, 1994, at 14-18, and AT&T Petition for Reconsideration, filed June 5, 1995, at 7-9, in *The NYNEX Telephone Companies Petition for Waiver -- Transition Plan to Preserve Universal Service in a Competitive Environment*, 10 FCC Rcd. 7445 (1995); AT&T Comments, filed May 16, 1995, at 28-35, in *Ameritech Operating Companies (Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region)*, Order, FCC 96-58, 11 FCC Rcd. 14028 (1996).

⁸³ Comments, CC Docket 96-45, filed December 19, 1996, by GTE at 40; Pacific at 27-30; SBC at 35-36.

requires "equitable and nondiscriminatory contribution to the preservation and advancement of universal service" by *all* telecommunications providers.

Accordingly, the Commission should remove the cap on subscriber line charges for all lines, and thereby allow the SLC to rise (where necessary) to a level that permits full recovery of the interstate portion of all loop plant-related NTS costs from the subscriber -- while assuring that consumer prices for telecommunication services overall will fall by at least the SLC increase. The subscriber should pay on a flat-rate basis, not only for the cost of the outside loop plant, but also the NTS costs of the associated line card (i.e., the loop termination at the local switch),⁸⁴ and any retail marketing expenses that are currently included in access charges. See infra Sections IV.B and V.B.1.⁸⁵

Although the NPRM (§ 65) proposes to eliminate the SLC cap for multi-line business customers and residential lines beyond the primary line, that is insufficient to achieve a cost-based rate structure. The Commission has recognized that "[w]hile the maximum SLCs for residential and single line business customers are lower than the maximum SLCs for multi-line

⁸⁴ In both the NPRM (§ 72) and the Access Charge Order § 91, the Commission recognized that, like the loop itself, the interface between the subscriber line and the local switch is a nontraffic-sensitive dedicated facility.

⁸⁵ As the NPRM acknowledges (§ 249, citations omitted), the Commission in 1987 agreed with a Joint Board recommendation to exclude interstate access revenues from the allocation factor used to apportion marketing expenses between the jurisdictions. Because the proposal was never implemented (to avoid jurisdictional shifts), marketing expenses are over allocated to interstate. See infra Section V.B.1.

business customers, this difference in the rate cap is not based on cost."⁸⁶ Accordingly, the SLC cap should be removed for all lines.⁸⁷

Moreover, the Commission has already correctly concluded that "the implementation of the SLCs has produced significant benefits, leading to lower interstate toll rates and increased economic efficiency. SLCs have also reduced the untargeted support flows between high and low volume toll users."⁸⁸ The Commission should permit the efficiency-enhancing benefits of the SLC to be fully realized by allowing the SLC to recover all NTS interstate costs not just in price cap territories, but for all ILECs.⁸⁹ As U S WEST has noted, "failure to increase the SLC would only require additional funds and funding mechanisms for the USF or other explicit-subsidy mechanisms, in light of the fact that the implicit subsidies are now prohibited under the 1996 Act."⁹⁰ And, as Sprint correctly concludes, "pricing distortions are avoided by recovering loop plant costs from the cost causer, eliminating the interstate CCL,

⁸⁶ End User Common Line Charges, Notice of Proposed Rulemaking, CC Docket No. 95-72, 10 FCC Rcd. 8565, 8577 (1995) (emphasis added).

⁸⁷ To achieve full cost-based recovery of loop-related costs, the Commission should adopt cost-based ratios of NTS costs for BRI ISDN and PRI ISDN to standard analog service, as suggested in the NPRM (§ 70, Tables 2 & 3), to determine the appropriate assessment of SLCs on BRI ISDN and PRI ISDN derived channels.

⁸⁸ End User Common Line Charges, 10 FCC Rcd. at 8573-74.

⁸⁹ When adjusted for inflation (based on a 30 percent increase in the consumer price index from 1989 to 1997), today's equivalent of the \$3.50 SLC, first initiated in 1989, would be \$4.55. Accordingly, if the residential and single-line SLC were raised to this level in some serving areas, it should not jeopardize subscribership. In all events, if a subsidy to preserve universal service were required, it would be provided through the new USF.

⁹⁰ U S WEST Comments, CC Docket 96-45, filed December 19, 1996, at 23. See also GTE at 40-41; SBC at 35-36; USTA at 20-21.

and decreasing the interstate local switching rate by the amount associated with currently allocated NTS loop costs."⁹¹ Should removal of the SLC cap require additional subsidies for some customers, those subsidies will be provided through a competitively neutral USF to compensate for the shortfall. For all of these reasons, the CCLC will be superfluous and must be eliminated immediately.

B. The Rate Structure For Local Switching Should Include Port Charges And Usage-Sensitive Charges.

Moreover, a combination of a flat-rate and usage charges would best reflect the way costs for local switching are incurred, and would therefore be reasonable.⁹² The Commission is correct in tentatively concluding that a "significant portion of local switching costs . . . likely do not vary with usage" and, as AT&T, MCI and Ameritech pointed out in the Docket 96-98 proceedings, are driven by the number of lines and trunks connected to the switch. NPRM ¶¶ 72-73. Accordingly, the local switching rate structure should include both usage-sensitive and flat-rate elements.

Implementation of this principle turns on a proper understanding of the manner in which access service is actually provided. Each line card that terminates a subscriber loop at the local switch is dedicated to a particular user and represents an NTS cost, which, like the loop, should properly be charged to the subscriber via the SLC. Trunk ports that terminate dedicated transport facilities at the local switch are also nontraffic-sensitive and should be recovered via a flat-rate charge to the carrier.

⁹¹ Sprint Comments, CC Docket 96-45, filed December 19, 1996, at 16.

⁹² *Local Competition Order* ¶ 810.

By contrast, those trunk ports used to terminate common transport facilities should be charged for on a usage-sensitive basis to reflect the shared nature of those facilities. Moreover, usage-sensitive charges based on calling volume should be used to recover the remaining costs of the central processing functions and switch capabilities used to provide access. Although AT&T has no objection to further refining the recovery of the traffic-sensitive costs of the local switch into a call set-up charge and separate per-minute charges, it does not believe that a separate set-up element is necessary, given that many call set-up costs are now allocated to signaling, and the proposed rate structure for signaling includes signaling message charges for all calls, whether completed or not.⁹³ Moreover, the Commission did not require a call set-up charge as part of the rate structure for the unbundled local switching rate element, which performs the same function as local switching in access. Thus, for consistency, a call set-up charge should not be part of the mandatory local switching rate structure.⁹⁴

The Commission, moreover, should avoid peak/off-peak pricing for local switching. Even if such a price structure could be constructed to reflect the incremental costs of adding traffic at peak hours, it would add an altogether unnecessary level of complexity. As the Commission has recognized, there are numerous practical problems associated with peak-

⁹³ If the Commission decides to adopt a call set-up charge for local switching, it must increase the productivity factor in the price cap formula, because in recent years the growth in messages has significantly exceeded the growth in minutes. Thus, absent this adjustment, price cap LECs can achieve higher revenues simply by charging for access based on their message volumes than by billing based on minutes of use.

⁹⁴ *Local Competition Order* ¶ 810.

sensitive pricing, including the fact that different parts of a given ILEC's network may experience peak traffic volumes at different times, with peak periods differing between business districts and residential areas.⁹⁵ Most fundamentally, however, given the relatively small ratio of interstate access to total traffic handled at a local switch, it is unlikely that any benefit of peak-load pricing would outweigh the costs of implementation.

Moreover, for peak-load pricing to result in greater efficiency, the cost differential would have to be reflected in rates paid by end users. However, there are numerous obstacles that make it difficult, if not impossible, for IXC's to adjust their rates to reflect peak/off-peak access charge differentials. These include the fact that peak periods differ among ILEC switches and between ILEC's and IXC's, and that Section 254(g) imposes certain rate averaging requirements. Peak-sensitive pricing should be avoided for all these reasons.

C. The Commission Should Eliminate The Transport Interconnection Charge, Adopt A Bifurcated Rate Structure For Tandem-Switched Transport, and Retain the Current Structure For Direct-Trunked Transport and Entrance Facilities.

After eliminating the CCLC, the other obvious change the Commission should make to bring the Part 69 rules more in line with cost-causation principles is to eliminate the transport interconnection charge ("TIC"). As the Commission acknowledges (NPRM ¶¶ 7, 43-44, 82, 96-97), the TIC is a non-cost-based, non-facilities-based, usage-sensitive charge; it is assessed on all switched access minutes (including expanded interconnection) and accounts for 70 percent (or \$2.9 billion) of the ILEC's switched transport revenues. Because the TIC increases per-minute charges paid by IXC's and long distance customers, it encourages bypass

⁹⁵ Id. ¶ 756.

of switched access. Moreover, to the extent the TIC recovers costs that are more appropriately recovered by transport facility charges, it distorts competition because it allows ILECs to price their transport facilities below cost and thus below the prices charged by transport competitors.⁹⁶

Because of these substantial flaws, the Court of Appeals has admonished the Commission to "move expeditiously . . . to a cost-based alternative to the RIC, or to provide a reasoned explanation of why a departure from cost-based ratemaking is necessary" ⁹⁷ Despite this explicit judicial directive, the Commission's own recognition that pricing of access at forward-looking economic cost best furthers efficiency (Access Charge Order, 93 FCC 2d at 251; NPRM ¶ 222), the 13-year transition that the industry has had for transitioning to cost-based transport rates (CompTel v. FCC, 87 F.3d at 530), and the fact that the new USF will supply any necessary subsidies (some of which may be recovered through the TIC today), the NPRM (¶¶ 99, 115-18) nonetheless suggests a need for some further TIC transitional mechanism, such as reassigning the most readily identifiable costs in the TIC and phasing out the remainder over three years.

AT&T strongly opposes this approach. The 1996 Act requires the Commission to remove all implicit subsidies from access, and to price access at TELRIC. Accordingly, using this measurement, all facilities-related costs currently recovered via the TIC will be recovered

⁹⁶ ILECs are able to do that because the TIC is applied to all minutes at the local switch, regardless of whose transport facilities the IXC uses.

⁹⁷ CompTel v. FCC, 87 F.3d at 532.

from the access rate elements set at TELRIC. Any remaining amount must be eliminated from access charges immediately.

With the elimination of the TIC, AT&T supports the Commission's basic framework in which the transport rate structure consists of charges for: (1) entrance facilities, (2) direct-trunked transport, and (3) tandem-switched transport. NPRM ¶ 84. Flat-rate charges for entrance facilities and direct-trunked transport, which were implemented at the end of 1993 with the restructure of local transport, reflect the way in which costs are incurred because the facilities used to provision these services are dedicated to a particular carrier. Once rates are set at TELRIC, moreover, there should no longer be a need for DS3-to-DS1 benchmark ratios. ILEC proposals to differentiate their services by various criteria, such as whether the IXC or ILEC has facility assignment control, should be justified on the basis of TELRIC support.

Consistent with the Commission's policy of unbundled rate structures, the unitary structure adopted as an interim measure for tandem-switched transport should be discarded and replaced with unbundled rates. By ignoring the separate and distinct components of tandem-switched transport, the bundled, unitary structure fails to promote either efficiency or the possibility of competition for the individual components of tandem-switched transport. Because interoffice facilities from the IXC's serving wire center ("SWC") to the access tandem are dedicated to the IXC's own use, fixed monthly charges should apply, reflecting the way these costs are incurred. This will provide appropriate incentives for IXCs to order facilities so as to achieve optimal loading of their traffic. Conversely, the use of facilities from the access tandem to the end office should be priced on a per-minute basis, as these facilities are

used in common with other traffic handled by the LEC. Principles of cost-causation also support mileage-sensitive rates based on the mileage of each specific link ordered by the customer. Cost-based mileage charges would encourage carriers to order facilities in a manner that minimizes routing distances, as well as to place their POPs in the most efficient locations.

The tandem switching charge must be cost-based to avoid the distortions and inefficiencies uneconomic prices invariably create. Establishing this charge on the basis of forward-looking economic cost will address the concerns of smaller IXC's that Part 69 assigns excessive costs to the tandem switching category. Such a policy will also be responsive to the Court of Appeals' finding that the Commission's action in assigning only 20 percent of Part 69 costs (with the remainder recovered from the TIC) was arbitrary and unsupportable. As with the pricing of local switching, a flat-rated charge for the dedicated ports on the SWC side of the tandem switch would be reasonable, and peak/off-peak pricing should not be adopted.

D. The Commission Should Adopt Its Proposed Unbundled Rate Structure For SS7 Signaling.

The Commission should also adopt its proposed unbundled rate structure for SS7 signaling. The present rate structure for recovering SS7 network costs includes two flat-rated rate elements: a Signal Transfer Point ("STP") port termination charge and a dedicated network access line ("DNAL") charge. 47 C.F.R. § 69.125. The Commission seeks comments on a revised structure with four unbundled charges, modeled after the structure permitted in the Ameritech waiver. See NPRM ¶ 127. The four unbundled charges are for the: (1) signal link; (2) STP port termination; (3) signal transport; and (4) signal switching.

Because the signal link is a dedicated facility connecting the IXC to the ILEC's STP, the flat-rated, distance-sensitive recovery proposed in the NPRM is appropriate.

Similarly, because STP ports are dedicated to individual customers, the proposed flat-rate STP port termination charge is consistent with cost-causation principles.⁹⁸

The signal transport element, however, would recover the cost of transporting messages within the ILEC's signaling network.⁹⁹ Because signal transport uses shared facilities, these costs should be recovered on a distance-sensitive, per-message basis.¹⁰⁰ Flexibility should also be provided to allow the ILEC to establish separate TCAP and ISUP signal transport rate elements because the length of a TCAP message is shorter than the length of an ISUP message.

The proposed signal switching element would recover the costs of switching signaling messages at the ILECs' STPs. These costs are appropriately recovered via a simple per-message charge. Separate signal switching charges for ISUP and TCAP messages could also be appropriate, if the measurement costs do not outweigh the benefits.

⁹⁸ The STP is a packet switch that switches SS7 messages within the ILEC signaling network.

⁹⁹ Under the present rate structure, the costs of signaling transport and signal switching at the ILEC STP are improperly recovered via either the TIC or local switching rate elements. See NPRM ¶ 126.

¹⁰⁰ Signaling messages are related to either establishing circuit-related functions for telephone calls or for queries to end offices or databases necessary to provide specific features such as CLASS (e.g., Automatic Call Return and Caller ID), or toll-free service. The circuit function-related messages are known as ISDN User Part Messages ("ISUP"), and those related to the queries are termed Transaction Capabilities Application Part ("TCAP") messages.

E. The Commission Should Establish Cost-Causative Rate Structures for SONET and AIN.

The NPRM (§ 139) also seeks comment on the appropriate rate structures for new technologies, such as Synchronous Optical Network ("SONET") and Advanced Intelligent Network ("AIN").

SONET, a transport vehicle capable of transmission rates in the gigabit per-second range, can be provided to customers using either dedicated or shared bandwidth.¹⁰¹ The dedicated bandwidth rate structure should reflect the distinct costs associated with providing: the channel interface (based on the type of line card, e.g., OC3, STS-1, the customer desires), the capability to aggregate and disaggregate traffic at the customer and central office nodes, and the bandwidth dedicated to the customer. Each of these elements should be priced on a flat-rate basis to reflect how the costs are incurred.¹⁰² The rates for the transport media should be structured to reflect the per-mile cost of the fiber-based facilities used to provide the bandwidth.

AIN services are provided utilizing the capabilities and functions of existing network facilities and functions.¹⁰³ The rates for switching, transport, and signaling (as described in

¹⁰¹ SONET technology is implemented using optical fiber-based transmission media that can connect multiple end offices. Access to the media is accomplished with the use of an add/drop multiplexer, and line cards that allow facilities to be physically connected to the add/drop multiplexer. Add/drop multiplexing is the feature that allows traffic to be selectively aggregated or disaggregated on the transport media.

¹⁰² When SONET is provided to a variety of customers on a shared bandwidth basis, the costs should be recovered on a per-circuit (e.g., DS3) basis.

¹⁰³ An AIN service is provided with the use of the software that allows the local switch to
(continued...)

earlier subsections) recover the cost of each component. AT&T suggests that the costs associated with the actual use of the AIN database be recovered on a per-message basis.

F. Terminating Switched Access Charges In Excess Of Costs Should Be Recovered From The End User.

Finally, certain changes should be made to the Commission's regulation of terminating switched access charges, particularly insofar as those charges relate to CLECs. Specifically, if a CLEC's terminating switched access charges are set equal to or lower than the local ILEC's charges -- which would be set at long-run incremental cost -- the CLEC's charges should be presumed lawful. To the extent the CLEC wishes to charge a higher rate, however, any amount above the ILEC's rate must be recovered from the CLEC's end user, i.e., the called party, unless the CLEC can demonstrate that the charge is cost-based. These measures are necessary to ensure that all interstate access services are priced at long-run incremental costs and do not thwart competition, either for access, or in other markets such as interexchange.

V. THE PART 61 PRICE CAP RULES SHOULD ALSO BE MODIFIED TO COMPLY WITH THE ACT'S REQUIREMENTS.

In addition to amending the Part 69 rate structure rules for switched access, the Commission will also need to make certain modifications to the price cap regulations in Part 61 of the Commission's Rules. This is true, moreover, regardless whether the Commission

(...continued)

determine that a particular customer's line is subscribed to an AIN function. On activation of the AIN function, the call is routed according to instructions that are contained in the AIN database.

adopts a "market-based," "prescriptive," or hybrid approach to access reform. For example, if the Commission adopts a market approach, and even if some carriers satisfy the requirements for relaxed rate regulation, others will not, and continued price cap regulation will therefore be necessary as to them. And, if the Commission adopts a one-time readjustment of LECs' access rates, continued price cap regulation will be needed to ensure that those rates do not increase in "real" terms -- i.e., after adjusting for inflation and productivity growth.

Some of the necessary adjustments to the price cap rules flow almost automatically from the changes to the Part 69 rate structures described above. For example, elimination of the CCLC will require the removal of that element from the common line basket, just as elimination of the TIC will require the removal of that element from the trunking basket. Similarly, the creation of a new local switching rate structure as discussed above will require appropriate modifications to the price cap rules, as will the creation of a bifurcated rate structure for tandem-switched transport, appropriate treatment of general support and computer-related expenses, and the Commission's proposed unbundled structure for SS7 signaling.¹⁰⁴ However, three additional changes to the price cap regulations, described below,

¹⁰⁴ The NPRM also seeks comment on price cap treatment of SS7 services. Currently, signaling charges are included in the trunking basket as Signaling for Tandem Switching Service. The Commission correctly proposes to include the STP port termination charge in the traffic-sensitive basket and leave the unbundled link in the trunking basket. This is clearly necessary, because otherwise, as the NPRM (§ 130) notes, ILECs will be able to respond to competitive pressures in their signal link business by simply raising the level of the STP port charge. The other proposed unbundled signaling elements, *i.e.*, signal switching and signal transport, are shared transport offerings and thus should be placed in the trunking basket in a separate service category.

are equally essential if the Commission is to satisfy its obligation to ensure cost-based access rates.

A. All Express Cross-Subsidies Must Be Removed From Price Caps.

Perhaps it goes without saying that express subsidies should be removed from carriers' price caps, i.e., that those caps should be reduced by an amount equal to the amount of such subsidies if that result is not accomplished through a reinitialization of the access caps. Failure to remove these subsidies would, at best, substantially reduce the price caps' ability to assist in driving access rates toward long-run incremental cost. At worst, it would allow a LEC to recover the same subsidy twice -- once in the form of the subsidy, and again in the form of a charge to customers for an item that is supposed to be covered by the subsidy. The Commission should therefore be vigilant in ensuring that all such subsidies are removed from price caps.

In particular, the Commission should ensure that universal service-related subsidies are removed from access price caps once the Commission completes its pending USF proceeding in Docket No. 96-45. In that docket, the universal service Joint Board has proposed to replace the current system of implicit universal service-related subsidies with a competitively neutral system in which carriers would be provided subsidies directly from a new universal service fund. Obviously, those subsidies, whatever their magnitude, should be deducted from the LECs' price caps.